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SUBJECT: SCENESETTER FOR UNDERSECRETARY HUGHES

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¶1. (SBU) Summary: You will arrive in Peru as President Alan Garcia closes his first year in office with a bang and with a whimper. The bang is the probable approval by the U.S. Congress of the U.S.-Peru Trade Promotion Agreement (PTPA). The PTPA has been the centerpiece of Garcia's market-oriented, investment-friendly economic strategy and should help Peru maintain its torrid economic growth, which reached nearly 8 per cent in 2006. The whimper is the public's disappointment at the government's slow pace in converting that growth into palpable poverty reduction. Public frustration caused widespread protests in July and has eroded Garcia's popular support nationwide. In relations with the United States, Garcia has emphasized the confluence of our mutual interests, most notably, in combating narco-trafficking, in promoting a democratic, free market vision of society, and in countering the regional security threat posed by President Hugo Chavez's "Bolivarianism." Peru's economic boom and a talented Cabinet eager to address the challenges facing the country suggest that the democratic consolidation witnessed during Garcia's first year in office will continue. End Summary.

Garcia after One Year

¶2. (SBU) You will arrive in Peru just after the administration celebrates one year in office, on July 28 -- a time when news stands and airways traditionally are filled with intensive appraisals of the government's performance. The news is mixed. Since taking office, Garcia has calmed skeptics who feared a return to the economic mismanagement and populist spending of his first term (1985-1990). Instead, he has stayed the economic course carved out by his predecessor Alejandro Toledo, maintaining macro-economic stability (less than 1 per cent inflation) and overseeing the sixth straight year of impressive GDP growth, almost 8 per cent in 2006 and more than 7 percent in 2007, despite a recent drop in commodity prices.

¶3. (SBU) Garcia, moreover, appears poised to achieve his top strategic goal: approval by the U.S. Congress of the PTPA. Peru's Congress overwhelmingly passed amendments strengthening key labor and environmental provisions June 27,

and the agreement now awaits final approval by the U.S. Congress. PTPA approval would provide a powerful political boost for Garcia, give Peruvian exports permanent, tariff-free access to the U.S. market, and help ensure continued strong economic growth.

The Need to Deliver

¶4. (SBU) The GOP's principal domestic policy goal has been to convert this solid economic performance into palpable benefits for all Peruvians. According to the National Statistics and Information Institute, in 2006 44 per cent of Peruvians lived in poverty, a 4 percent drop from 2004, a result of the macroeconomic policies pursued by ex-president Alejandro Toledo. But this reduction in poverty largely took place within the relatively prosperous coastal provinces, leaving stubbornly high poverty rates -- as high as 70 to 80 percent -- in the politically volatile southern Sierra region where Garcia has never been popular. Senior officials recognize the urgent need to reduce poverty and provide better social services -- particularly quality education in public schools and greater access to health care. In response, the Garcia administration has pursued a host of initiatives, including building access to clean drinking water for poor rural and urban communities, linking small rural producers to national and international markets, expediting the flow of public purchases and investments, and transferring bureaucratic functions to regional and municipal governments.

¶5. (SBU) The GOP, however, has bumped against the structural limitations of a dilapidated and often dysfunctional state. The underlying problem is that state mechanisms, particularly at the local level, have proven incapable of administering the abundant resources made available by the economic boom. Another aspect of the problem is the lack of talented administrators, who have fled to better paying jobs in Lima, leaving municipalities unable to manage basic public services.

Protests and Falling Polls

¶6. (SBU) Fairly or unfairly, the dearth of high-impact projects has been perceived by many as a failure by government to deliver on its campaign promises, resulting in a steady erosion of Garcia's popular support: in August he received a 63 per cent approval rating, which had dropped to 36 per cent by July 2007. The Peruvian Congress has fared even worse and in recent national polls received an approval rating of less than 17 per cent, a result of a series of scandals that involved fifteen of Peru's 120 legislators. Despite his growing unpopularity, Garcia shows no sign of abandoning his pro-market economic vision and returning to the ill-fated populism that marred his first term. By comparison, Toledo received only a 16 percent approval rating after his first year in office.

¶7. (SBU) Pent-up frustration at the slow pace of reform fueled a tumultuous month of protests in July, when a total of 35 major protests took place in 16 of Peru's 24 departments. A wide variety of causes sparked the unrest: teachers protesting mandatory testing; miners seeking an end to subcontracting; regional presidents calling for more public works; and ne'er do wells seizing the chance to sow trouble. The GOP proved adept at addressing the localized causes of the unrest, and so far, the widely-separated demonstrations have failed to produce a national movement, although Peruvian officials are convinced that Venezuelan money is helping organizers coordinate more effectively. Even though Caracas remains active in trying to exploit localized discontent, poverty and discrimination remain the fundamental causes of unrest. Although strikes have largely ended, the cycle of protest could resume during your trip.

¶8. (SBU) Garcia's foreign policy aims to complement his domestic focus on growth-led poverty reduction by prioritizing ties with pragmatic integration-minded, pro-growth countries, including Chile. Steps to intensify and expand Peru's relationship with Chile have been at the center of this effort and engendered what the GOP sees as an informal "axis" of Pacific coast nations -- including Chile, Peru, Colombia and Mexico -- that can counterbalance the destabilizing influence of Chavez in the region. The point of this pragmatic posture is to demonstrate that trade-friendly democracies offer more opportunities than that static, state-dominated alternative. The momentum for a closer working relationship with Chile was slowed by the GOC's July 11 decision not to extradite former president Alberto Fujimori (the GOP has appealed), but most critics blamed the Toledo Administration for submitting a flawed legal brief, and Garcia is likely to continue the pragmatic orientation of his regional policy.

Relations with the US

¶9. (SBU) Garcia's emphasis on deeds and results, not rhetoric or confrontation, has coincided with a period of intense and productive relations with the USG. Garcia sees strong ties with the U.S. as an essential component of both his economic and security policies. He has traveled to Washington twice, first in October 2006 and again in May, when he met with President Bush and a number of key congressional leaders to underscore the importance of the PTPA. Garcia has personally received a stream of official U.S. visitors to Peru, including Deputy Secretary of State Negroponte, Treasury Secretary Paulson, and then-Director of Foreign Assistance Tobias. He has also received several congressional delegations, including the high profile visit of Senate Majority leader Reid. President Garcia's foreign policy team has been pleased by the policy attention from Washington.

¶10. (SBU) The Garcia government has also proven to be a reliable U.S. partner as a rotating member of the UN Security Council. Peru has supported a number of key U.S. and European UNSC initiatives, including on North Korea, Sudan, Iran, Haiti and Kosovo. While Peru has sought to avoid controversy and to support consensus positions, bilateral calculations have tipped the scales in most of the government's decisions, which Garcia has often taken himself. In his meetings with President Bush, Garcia has demonstrated a keen engagement with issues of global security, particularly on Iran and North Korea.

¶11. (SBU) In the fight against drug trafficking, Garcia has emphasized publicly that counter-narcotics efforts, including forced eradication, will continue, and he has vowed that there "would be no treaty in the war against drugs." Part of Garcia's strong public stance was a reaction to the unauthorized talks that former Agriculture Minister Juan Jose Salazar held with cocaleros in the early part of 2007, talks that emboldened cocalero leaders to seek more concessions through protests. Garcia sacked Salazar May 22 and replaced him with a respected businessman who said he would not allow cocaleros to dominate his ministry's agenda. UN figures showed coca cultivation increased slightly in 2006.

¶12. (SBU) Finally, the GOP shares a strikingly similar world view with the United States, particularly with respect to the nature of the security threats we face in the region and around the globe. In this connection, Peru sees transnational threats such as narcotics trafficking, terrorism, smuggling, trafficking in persons, and piracy as the main menaces facing the region. The GOP remains concerned about Venezuela's attempts to foment instability and fuel conflict in marginalized sectors of Peruvian society.

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